Midwest Corporate FEDERAL CREDIT UNION

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March 13, 2009

The Honorable Michael E. Fryzel
Chairman, National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood
Vice Chairman, National Credit Union Administration

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

Re: Comments on Advanced Notice of Proposed Rulemaking for Part 704

Sent via Email to: regcomments@ncua.gov

Dear Chairman Fryzel, Vice Chairman Hood, and Board Member Hyland:

Midwest Corporate Federal Credit Union (Midwest Corporate) appreciates the opportunity to comment on the Advanced Notice of Proposed Rulemaking and Request for Comment (ANPR) regarding corporate credit unions.

Midwest Corporate is a $248 million corporate credit union (12-month DANA as of February 28, 2009) that serves as the primary correspondent financial institution for 49 credit unions within the State of North Dakota and as a secondary correspondent financial institution for 12 credit unions outside of North Dakota.

Midwest corporate provides traditional correspondent services to its members including item processing, check collection, wire services, ACH services, investment offerings, Certificate of Deposit brokering, lines of credit, and other services. While members have other options for most of these services, Midwest Corporate is the low cost provider for our members.

Midwest Corporate understood the need for the NCUA Board to take action on January 28, 2009 to help stabilize the corporate credit union network. However, we are concerned that in an effort to act quickly, not enough analysis will be done to rationally determine the true causes of the current losses within the corporate credit union network and if there truly were any ways to prevent or mitigate the losses. Although very large, only a handful of corporate credit unions actually could not bear the pressures of the current market dislocations and associated accounting rules. We believe that this very simple observation is a clear indication that the two tier corporate credit union system was not the cause of the problems, but, perhaps the expanded authorities that the NCUA approved for those corporate credit unions were. Expanded authorities had the effect of encouraging unwarranted risk taking and concentration risks. Therefore, we ultimately believe that restructuring of the corporate credit union system is not the solution to today's issues. However, we do believe that Parts I, II, III, IV, and V expanded authorities within the current regulations should be repealed for retail corporate credit unions to force retail corporate credit unions to operate as at a Base or Base-plus operating authority. We further believe that U.S. Central FCU as a wholesale corporate credit union needs to continue to exist as an aggregator of deposits and payment system transactions, and as a liquidity provider (line of credit) for retail corporate credit unions. We further believe that U.S. Central FCU should be permitted to retain some form of expanded authorities to properly fulfill its mission and be permitted to offer term investments as long as the leveraging of its balance sheet is kept to a minimum.

Overall, Midwest Corporate believes that there is no evidence that the artificial consolidating of corporate credit unions, or elimination of the two tier corporate credit union system, will lead to more efficiencies. In fact, if corporate credit union mergers in recent years are any indication, the consolidation into ever larger retail corporate credit unions leads to less efficiency and more risk for the system. Ironically, the medium to large retail corporate credit unions that have gotten large due to member growth and usage seem to operate in a similar manner to the smaller to medium size retail corporates and seem to be the most efficient of the their peers.

To address specific requests for comments within the January 28, 2009 ANPR, we offer the following comments:

1. *Role of Corporates in the Credit Union System*

Midwest Corporate disagrees with the APNR's initial statement in this section that, "recent events have highlighted structural vulnerabilities in the corporate credit union system." We believe that recent events have highlighted problems with current regulation with regard to expanded authorities and improper supervision of those corporate credit unions that have been granted expanded authorities. We do not believe that eliminating the wholesale tier of the corporate system (U.S. Central FCU) will create any efficiencies or reduce system risk. We believe the exact opposite, eliminating the wholesale tier will create multiple corporate credit unions with higher levels of risk as they attempt to replace the services now offered by U.S. Central FCU and inefficiencies will develop as multiple corporate credit unions duplicate systems now provided to all corporate credit unions by U.S. Central FCU.

<u>Payment Systems</u>

Midwest Corporate does not believe creating two distinct corporate credit union charters for payment systems and investment services is practical or desirable. Payment system risk does need to be measured differently and those risks need to be mitigated differently than the risks associated with investment activities. Focus in this area should be on proper capital levels for the entire institution and proper liquidity to mitigate payment system risks.

We also do not believe establishing a, "… legal and operational firewall … between payment system services and other services" is necessary.

<u>Liquidity and Liquidity Management</u>

Providing liquidity to the nation's credit unions is a primary function of the corporate credit union system and should remain a focus going forward. However, possible limitations placed on corporate credit unions, including at the wholesale tier (U.S. Central FCU), could severely restrict the corporate credit union network from fully performing this vital function. Corporate credit unions should be able to utilize a number of options to provide liquidity, although, relying on leveraged investments should be restricted (not prevented, just restricted). Midwest Corporate believes that the current Regulation Part 704.9 is sufficient, however, the NCUA should be more critical of liquidity plans that rely too heavily on the sale of investments to meet expected demands. The sale of investments to meet expected demands within a liquidity plan should only be utilized to meet unusual or "worst case" situations.

Limiting product and service offerings by a corporate credit union through regulation in order to preserve the liquidity function of corporate credit unions is a bad idea. Proper liquidity management will have the effect of limiting services if it is necessary to meet liquidity expectations. Incorporating some standard within a regulation would be difficult and would not allow enough flexibility to properly manage the corporate credit union's balance sheet.

Midwest Corporate does not believe that incorporating cash flow duration in regulations is appropriate. While duration should be considered within a corporate credit union's operating policies and liquidity analysis, mandating duration limits would be arbitrary and restrict a corporate from adapting to the needs of its members. This should remain an oversight function of the regulator, not a limiting feature of a regulation.

Field of Membership Issues

With nearly all corporate credit unions having national fields of membership, and the overwhelming majority of corporate credit unions operating in a very safe and sound manner, reverting back to a regional field of membership is unnecessary. As would be expected, natural-person credit unions are attracted to different corporate credit unions for a variety of reasons, usually due to traditional relationships or for specific operational reasons. It would seem to be a disservice to natural-person credit unions to force the use of only one corporate credit union based on geographic location.

While a few corporate credit unions have viewed their national field of membership as a mandate to solicit business from outside their traditional primary markets, this has not been very successful and has lead to some price competition. However, any negative impact from this activity is more likely a function of a flawed business plan than a flaw of national fields of membership.

Rather than revoking national fields of membership, Midwest Corporate would suggest that each individual corporate credit union be allowed to establish different levels of membership through its bylaws. This would allow natural-person credit unions to get services from the corporate credit union that best suits its needs and allow a corporate credit union to limit particular services to a member credit union by geography, capital investments, etc.

Expanded Investment Authority

Midwest Corporate does not believe that expanded authorities have in and of themselves lead to better rates or better services. To the contrary, expanded authorities seem to have lead to unnecessary risk taking. While we believe that unnecessary risk taking has been the result of expanded authorities, the current investment OTTI issues facing a few of the corporate credit unions would not have been completely avoided if expanded authorities did not exist.

For some corporate credit unions, allowing expanded authority to "Base-Plus" may be acceptable, however, except for the wholesale tier of corporate credit unions, NCUA Regulation Part 704 – Appendix B – Parts I, II, III, IV, and V should be repealed. If these authorities are not repealed, the NCUA Regulation should require at a minimum, annual reauthorization of the authority. In addition, NCUA should have the authority to limit activity, or place additional requirements, within the authorization. This would allow the NCUA to determine proper authority based on a corporate credit union's capital levels and their ability to handle additional risks.

Structure; Two-Tiered System

Midwest Corporate operates under a business model that is centered around the two-tier corporate credit union system of one wholesale corporate credit union (U.S. Central FCU) aggregating transactions for payment systems, providing low risk term investment options, and providing significant lines of credit to retail corporates. This model does transfer and concentrate much of the investment risk taking to the wholesale corporate credit union, but, Midwest Corporate believes that this was the intent of the two-tier system and that it is appropriate.

Concentrating the risks to the wholesale corporate allows for better control and risk mitigations for the entire system. The up flow of investments to the wholesale corporate allows enough asset size for the wholesale corporate to develop proper systems and analysis to minimize risks better than can be done at the retail corporate level. While the current issues centering on the investment portfolio of the wholesale corporate are significant, and may warrant some future restrictions, they should not detract from the fact that the up flow of risk is a good idea. We have seen that allowing, or even encouraging, retail corporates to retain some of this risk through expanded authorities has not prevented or mitigated the problems we see today. It is our belief that had more of the risks been concentrated at the wholesale tier, the issues could have been dealt with in a more straight forward manner.

Should the wholesale corporate tier be left intact, Midwest Corporate would argue that the wholesale corporate credit union should be the only corporate credit union eligible for expanded authorities under today's regulations, allowing the wholesale corporate to invest in different investment vehicles than that permitted by retail corporates. However, restrictions on certain investments should be imposed with regard to credit quality and concentration limits. Capital for the wholesale corporate should be dictated by the risk it takes on. At a minimum, the wholesale corporate should be required to meet the same minimum capital requirements as retail corporate credit unions. In addition, additional member capital should be required, if needed, based on Basel standards.

2. *Corporate Capital*

Midwest Corporate supports revising the capital standards at corporate credit unions that provides for minimum capital requirements and brings corporate credit union capital requirements more into line with the standards applied by other federal regulators. However, while making this change, the NCUA must take into account any accounting or capital raising differences that exist due to the cooperative form of charter that a corporate credit union must operate under.

<u>Core Capital</u>

Midwest Corporate believes that total capital is the most important factor in determining the capital adequacy of any corporate credit union. However, a minimum level of core capital should be required. Midwest Corporate is in favor of a risk-based formula that would set minimum standards while requiring higher capital levels for more risky balance sheets.

Midwest Corporate supports a minimum risk-based core capital level of 4.00% by the end of 2010, if GAAP qualifying member Paid-in-Capital (PIC) is permitted to be included. We would be in favor of having up to 75 percent of core capital being in the form of PIC. In addition, a second level of total capital should be required that would include membership capital shares with a call feature. We believe that this minimum level should be in line with Tier 2 capital requirements as is required by other federal financial institution regulators.

Once the minimum capital standards are met, capital restoration plans should only be required if the core capital falls below the minimum for three consecutive months.

Member PIC should be required to comply with GAAP to qualify as perpetual capital. PIC should retain its current regulatory requirements with regard to its non-call feature by member-owners. PIC should only be allowed to be redeemed at the sole discretion of the issuing corporate credit union.

Membership capital shares should have notice periods extended to five years to make them qualify as Tier 2 capital under GAAP.

Capital ratios should use three-year daily average net assets as the denominator versus today's one-year daily average net assets. The use of daily average net assets is proper for a corporate credit union, given the volatility in the balance sheet size due to a corporate credit union's liquidity facility function. However, even from year to year the balance sheet can vary greatly, making minimum capital standards potentially difficult to meet. It is for this reason we favor a three-year daily average net assets.

Generating core capital through ongoing earnings will be difficult, therefore, Midwest Corporate does not favor any requirement in this area. Instead, the corporate credit union should develop its own standards as to how core capital requirements will be met.

While requiring credit union members to contribute capital in order to receive any services from a corporate credit union sounds like a good idea on its surface, Midwest Corporate believes that this is short sighted and arbitrary. Instead, Midwest Corporate favors allowing this to be a choice for a corporate credit union through its bylaws. We would also favor giving corporate credit unions the option to condition access to individual services based on contributed capital. This would allow the providing of low risk services without capital, but, requiring capital for higher risk services.

<u>Membership Capital</u>

Midwest Corporate believes that membership capital shares is an important piece of the total capital structure of a corporate credit union. We would favor extending the notice period by a member-owner to five years to make the membership capital shares conform to Tier 2 capital requirements under GAAP.

Retention of the membership capital shares is also important in properly adjusting any required capital investment by a member credit union. In regard to adjusting membership capital deposits, Midwest Corporate favors allowing the individual corporate to determine if it is to be based on the member's assets, activity level, or a combination of the two. We also favor allowing the corporate credit union to determine the frequency of any adjustments with a minimum of annually and no more frequently than quarterly.

The ANPR asks for comments on whether membership capital share withdrawals should be conditioned on a corporate credit union's ability to meet all applicable capital requirements following the withdrawal. Midwest Corporate believes that this is unnecessary, if a long notice period is provided for, that should be sufficient for a corporate credit union to plan for the withdrawal and develop a capital restoration plan if necessary.

<u>Risk-Based Capital and Contributed Capital Requirements</u>

As stated earlier, Midwest Corporate favors NCUA implementing a risk-based capital requirement consistent with requirements of other federal financial institution regulators.

Also, as noted earlier, Midwest Corporate does not favor mandatory capital contribution requirements, instead, favoring this to be a choice for a corporate credit union through its bylaws. We would also favor giving corporate credit unions the option to condition particular services based on contributed capital. This would allow for better matching of higher risk services to proper capital levels.

3. *Permissible Investments*

Midwest Corporate believes that allowing corporate credit unions greater flexibility in the types of investments permitted versus a natural-person credit union is necessary in order to allow the corporate to fulfill its mission. However, investment powers should be based on proper controls, risk, and concentration limits. While we do not favor continuation of expanded authorities for corporate investing at the retail corporate credit union level, we believe the current investment authorities available to base and base-plus operating level corporate credit unions are appropriate.

Midwest Corporate does not offer an opinion on limiting any specific type of investment indicated within the ANPR, instead, we believe that the NCUA needs to assess the risks of these investment types on corporate credit unions and determine if they are inherently risky as they have done in the past for natural-person and corporate credit unions.

4. *Credit Risk Management*

Midwest Corporate supports the continued use of Nationally Recognized Statistical Rating Organizations (NRSROs) as they still provide useful outside opinions on specific investments. While some have questioned their values over the past few years, Midwest Corporate believes that the major NRSROs have gotten better at indicating proper ratings, making their continued use valuable.

Midwest Corporate also favors the use of at least two NRSROs, using the lowest rating to satisfy any minimum requirement. Other than requiring two NRSROs for investments, other than in a corporate credit union, obligations of the United States, or a CUSO, Midwest Corporate believes the current regulations are sufficient.

5. *Asset-Liability Management*

The ANPR indicates that the problem of widening of spreads on various investments was one of the problems leading up to the current market dislocations. We do not believe this is a true inference. The spread widening was a symptom of the crisis in the markets, not a cause. However, reinstating mandatory modeling and testing of credit spread increases would be appropriate and should not overburden a corporate credit union.

6. *Corporate Governance*

Midwest Corporate believes that the current governance structure of democratically elected representatives from among the members is appropriate and consistent with the cooperative charter. However, we also believe that corporate credit unions, and their members, should have greater flexibility in the form of standard bylaw amendments with regards to; (1) term limits, (2) minimum requirements for directors (i.e. background, position within a member organization, etc.), (3) board seats dedicated to geography, assets size, at large, or a combination of the same, (4) allowing for an outside director, (5) director compensation, etc.

Ultimately, Midwest Corporate believes that corporate governance is a matter for the corporate credit union's membership to decide and that the NCUA regulations and standard corporate credit union bylaws should allow as much flexibility as possible. However, Midwest Corporate believes that the NCUA should not put into regulation minimum standards for a director of a corporate as this might eliminate interested candidates from the democratic process and could be a point of contention as the regulatory requirements may be interpreted differently.

The ANPR also asks for comments on. "… allow(ing) members of corporate credit unions greater access to salary and benefit information for senior management." Midwest Corporate believes that in this area, corporate credit unions should be held to the same disclosure requirement that may be in effect for a natural-person credit union.

Midwest Corporate would like to offer one other comment not asked for in the ANPR. The NCUA recently announced its intent to combine the Office of Corporate Credit Unions with another area of the NCUA. We feel that it is important that the NCUA maintain a separate and distinct Office of Corporate Credit Unions, equivalent to a Region, as it does today. This is important in order to properly supervise the corporate credit union system. The unique role, services, and balance sheet of a corporate credit union necessitates specialized examination skills and the ability to react quickly that can only be achieved as a distinct division within the NCUA.

Thank you for this opportunity to participate in this rulemaking process. We look forward to continued dialogue as regulations and rules are developed in the future. If you have any questions about our comments or recommendations, please contact me at (701) 250-3990 or via e-mail at doug@midwestcorporatefcu.org.

Sincerely,

Douglas Wolf
President/CEO